Deflation hits world's second largest economy

Unemployment at record levels in Japan

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Unemployment has risen to a postwar record in Japan, one of a number of indicators that the Asian economic crisis is intensifying a protracted slump in the world's second largest economy.

Last month, a record 160,000 workers were laid off, taking the official total of those without jobs to 2.46 million, or 3.6 percent of the work force. Significant job losses occurred in construction and manufacturing, following sharp falls in consumer spending.

These figures might appear low compared to the double-digit or near double-digit levels in Europe and Australasia, or even the current levels of 5 to 6 percent in the US, but they are devastating in Japan, where welfare provisions are virtually nonexistent.

Moreover, millions more workers are effectively jobless, or seriously underemployed, yet still regarded as employed under the system of "lifetime employment," whereby major companies have kept workers on their payrolls to prevent large-scale social unrest.

Widespread fear of unemployment, together with fewer people employed, lower bonuses, less overtime pay, and historically low pay rises, are leading to sharply reduced consumption. Retail sales in department stores and supermarkets fell 7.1 percent in February, the eleventh consecutive monthly decline.

As a result, a deflationary spiral has begun to emerge. According to last month's results, the consumer price index, excluding fresh food, rose just 1.8 percent over a year. Even this was an underestimate of the underlying trend. Excluding last year's 2 percentage point rise in consumption tax and a rise in medical charges, prices are now falling.

Capitalist commentators are warning that consumers will start to delay purchases in the knowledge that goods will be cheaper later. They say the corporate sector, already holding swollen inventories, will be burdened with depreciating assets and shrinking profit margins.

Already, companies are reacting to falling sales by cutting back investment. Japan's Long-Term Credit Bank warned that capital spending would fall 3.9 percent during the fiscal year starting in April—the first decline in four years. Overseas investment would plunge 23 percent. No less than 95.5 percent of the 352 companies it surveyed complained that raising capital had become more difficult.

This latter complaint reveals how directly the Asian crisis is hitting Japan. Japanese banks, already saddled with bad debts worth $600 billion, and now heavily exposed to currency and corporate collapses in Indonesia, Thailand and South Korea, have imposed a crippling credit squeeze on small and medium-sized businesses. Interest rates have plunged to near zero, but loan funds have dried up.

Such deflation has not been experienced in one of the headquarters of world capitalism since the 1930s. In the words of Max Walsh, a prominent newspaper columnist in Australia: "Japan is caught in a liquidity trap—interest rates are close to zero but personal spending and business investment are falling. The last time we saw this in an advanced economy was in the Great Depression."

Japan has been mired in slump for seven years, with its share market halving in value from the peak of 1989. Now, after averaging less than 1 percent annual growth throughout the 1990s, Japan's Gross Domestic Product has declined in the last half of 1997, and is expected to fall for the full 1997-98 fiscal year—the first such fall since the oil price shock of 1974.

Despite the rise of US and European share markets to giddy new heights in recent weeks, Japan's recession, on top of the Asian meltdown, has the potential to drag world capitalism as a whole into a deflationary circle of falling prices and profit margins, overproduction, competitive currency devaluations and fierce trade war.

The global implications of Japan's crisis can be seen in the fact that its economy is bigger than those of the United Kingdom, France, Italy and Canada combined. It accounts for nearly 20 percent of global output, two-thirds of East Asian production and nearly one-third of world savings.

Negative response to economic package

Just hours before the release of the latest indicators of recession, Japan's ruling Liberal Democratic Party announced a 16 trillion yen (US$120 billion) package of public works and other measures to stimulate the economy.

LDP spokesmen described the package, priced at 3 percent of GDP, as the largest yet undertaken. The measures were reportedly boosted by six trillion yen at the last minute in an attempt to reverse the slide into recession and win a favorable response from the Tokyo stock exchange.

However, the money markets, and commentators for Japan's US and other international rivals, responded negatively. The Nikkei share index fell 241 points to 16,736 on Friday, or 1.42 percent, wiping off the gains of the previous day. Bankers, business representatives and editorial writers condemned the package's lack of tax cuts and declared it likely to fail, just as surely as seven previous packages since 1992.

Successive Japanese governments have unveiled more than 75 trillion yen ($600 billion) in additional spending since 1992, an average of some 12 trillion yen per year. The latest package—to be officially announced by the Hashimoto government in mid-April—seems to be no different, except in its size. It reportedly consists primarily of bringing forward existing public works programs to the early part of the 1998 fiscal year, starting on April 1.

Although details have yet to be released, the package seems designed to further benefit the LDP's biggest financial contributors—the construction and banking giants that have profited from the previous packages. Japan already spends 50 trillion yen a year on construction projects, the highest in the world compared to GDP—and the industry now employs a staggering 11.7 percent of all Japanese workers—but the economy has remained stagnant.

The major features of the new package apparently include:

* Plans to spend 80 percent of the 1998 public works budget within the next six months.

* Massive handouts for new infrastructure, such as optic fibre, in the information and telecommunications industries to help Japanese conglomerates update and cut costs.

* Measures to allow funds from the government's post office and insurance savings system to be diverted into the banks.

LDP leaders said the package will not include the additional income tax cuts that have been emphatically demanded by the US administration. The Hashimoto government has insisted it cannot cut taxes because that would infringe the Fiscal Structural Reform Law—special legislation to reduce the budget deficit. Nevertheless, over recent months, Washington, the International Monetary Fund and the European powers have increasingly intervened into Japanese politics, calling for tax cuts, together with financial deregulation.

US Deputy Treasury Secretary Lawrence Summers responded coolly to the package, saying the US was "encouraged" but "obviously what will be crucial is what the details are and how the plan plays out. That's something we will be watching and studying carefully, and I am sure the markets will as well."

While fearful of the global implications of a Japanese economic crisis, US and European banks and big business are also in a frenzied drive to exploit Japan's slump by forcing up its domestic spending and busting open its markets, at the direct expense of giants such as Toyota, Honda, Mazda, Nissan, Mitsubishi, Sony, Sanyo, NEC, Toshiba, Hitachi and Fujitsu.

Various Washington commentators condemned the latest package for continuing to fatten the profits of politically well-connected Japanese businesses. "There is a sense of 'here we go again,'" charged Ed Lincoln, foreign policy analyst at the Brookings Institution. "This is a very traditional economic stimulus, the very measures that the Japanese have been telling everyone they were finished with."

A number of commentators in Australia's corporate-controlled media have accused Tokyo of using the stimulus packages to block the opening up of the Japanese economy. Greg Sheridan, for example, foreign editor of Rupert Murdoch's *The Australian*, railed against "ridiculous payoffs to the corrupt and politically powerful construction industry," and declared that such spending "reinforces the cronyistic, politically connected, non-commercial aspects of Japanese decision-making."

These statements reflect concern in Australian ruling circles that Australian-based companies are already suffering heavy losses as Japan's slump and the ongoing Asian crisis devastate their major export markets, and that Australian firms face even greater losses if caught in the crossfire of a US-Japan trade conflict.

Writing in the *Sydney Morning Herald*, Max Walsh declared there was a "real whiff of Smoot-Hawley in the way events are unfolding in Japan." He was referring to the highly protectionist Smoot-Hawley tariff bill passed by the US Congress in 1930, that deepened the global depression by setting off open trade war and competitive currency devaluations. Walsh accused the Hashimoto government of being dominated by domestic economic interests, just as US legislators were in 1930.

These interimperialist tensions are likely to heighten in the lead-up to the Group of Seven (plus Russia) summit at Birmingham, Britain on May 15. Prime Minister Ryutaro Hashimoto is under growing pressure to announce tax cuts before that meeting, even though such a public policy reversal to meet international pressure will almost certainly signal the end of his premiership.